

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE EAST LAUREL )	
WATER DISTRICT, OF LAUREL COUNTY, )	
KENTUCKY, FOR APPROVAL OF CON- )	CASE NO. 9525
STRUCTION, FINANCING, AND RATES )	

O R D E R

East Laurel Water District ("East Laurel"), by application filed March 17, 1986, is seeking a certificate of public convenience and necessity for a \$768,750 waterworks improvements project, adjustments to its water service rates and approval of a \$768,750 plan of financing composed of \$716,000 Farmers Home Administration ("FmHA") funds (\$355,000 loan and \$361,000 grant) and \$52,750 from applicants for water service.

The rates proposed by East Laurel would produce additional revenues of \$29,322 from the customers served during the test-year, an increase of 12.9 percent over test-year revenues. The determinations made herein provide for a \$25,894 or 11.7 percent increase from these customers and new revenue production of \$31,152. Customers added by growth throughout the existing system and in the new project area will produce the new revenues.

East Laurel serves about 1,347 customers in the southeastern corner of Laurel County between London and the boundaries of Clay and Knox Counties. An additional 211 residents of this area will become water service customers upon completion of the proposed construction.

The construction plans and specifications prepared by Kennoy Engineers, Inc., Consulting Engineers of Lexington, Kentucky, ("Engineer") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet.

A hearing was held in the offices of the Public Service Commission in Frankfort, Kentucky, on July 16, 1986. No intervenors appeared at the hearing and no objections to the proposed construction were received.

#### CONTINUITY OF ADEQUATE AND RELIABLE SERVICE

East Laurel's Engineer testified that reliable and adequate service can be maintained throughout the system after completion of the proposed construction. The Commission is concerned, however, that service to East Laurel's customers in the higher elevations of the service area may not be adequate in the long term.

The Commission reminds East Laurel of its obligation to provide adequate and reliable service to all of its customers by monitoring the adequacy of the water distribution system after construction is completed. If this monitoring indicates that service pressures are inadequate or declining, appropriate action must be taken to assure that service pressures required by Commission regulations are maintained.

#### TEST PERIOD

East Laurel proposed and the Commission has accepted the 12-month period ending December 31, 1985, as the test period in this matter. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

## REVENUES AND EXPENSES

East Laurel proposed several adjustments to revenues and expenses in its original application. The Commission has made, for rate-making purposes, the following modifications to these proposals:

### Purchased Water Expense

East Laurel reported test-period purchased water expense of \$84,778 based on 105,972,400 gallons purchased, of which 76.9 percent (81,502,000 gallons) was sold and 23.1 percent (24,470,000 gallons) was reported as unaccounted-for water. The district offered no justification for exceeding the 15 percent maximum for unaccounted-for water allowed by the Commission for rate-making purposes. Therefore, based on sales of 81,502,000 gallons and the Commission's normal practice of allowing no more than 15 percent unaccounted-for water, East Laurel's allowable test-period purchased water expense has been reduced to \$76,708 for rate-making purposes.

East Laurel proposed an adjustment of \$10,262 to test-period purchased water expense to allow for service to 182 additional residential customers upon completion of its proposed construction. At the hearing East Laurel stated that its construction will serve 211 additional customers rather than 182. Based on the test-period average usage for residential customers of 5,176 gallons per month and an allowance of 15 percent for unaccounted-for water, the Commission has determined that the adjustment to East Laurel's allowable test-period purchased water expense should be \$12,335. Therefore, the Commission has allowed,

for rate-making purposes, a total purchased water expense of \$89,043.

#### Pumping Expense

East Laurel's test-year pumping expense per the staff audit report was \$5,601. East Laurel proposed an adjustment of an additional \$10,623 to pumping expense in its original application. However, at the hearing, East Laurel corrected this, stating that the proposed adjustment should have been only an increase of \$5,022, for a total expense of \$10,623. However, this expense of \$10,623 was based on estimated maximum usage rather than estimated average daily usage. At the staff's request, East Laurel filed a calculation of the estimated annual pumping expense based on estimated average daily usage, which resulted in a reduction of \$708 to the test year amount of \$5,601. The Commission agrees with East Laurel's revised estimate and has included, for rate-making purposes, pumping expense of \$4,893.

#### Meter Reading Labor

East Laurel proposed an adjustment of \$1,431 to test-year meter reading labor to reflect 182 new customers. However, since East Laurel will be serving 211 additional customers, the Commission has included, for rate-making purposes, an adjustment of \$1,648 to reflect this number.

#### Office Supplies and Other Expenses

East Laurel has contracted for office services with Laurel County Water District No. 2, at an annual cost of \$27.60 per customer. East Laurel proposed an adjustment of \$5,023 for 182 new customers. However, as East Laurel will be serving 211

additional customers, the Commission has included, for rate-making purposes, an adjustment of \$5,824 to reflect this number.

#### Depreciation Expense

East Laurel's test-year depreciation expense per the staff audit report was \$35,217. A portion of the gross utility plant-in-service is contributed property and the Commission has made an adjustment to test-year depreciation expense because it is of the opinion that allowable depreciation expense, for rate-making purposes, should be calculated only on plant funded with capital other than contributions in aid of construction. Such a method insures that ratepayers pay only for the plant in which the utility has made an investment and not the plant which the utility has acquired at no cost.

According to East Laurel's 1985 Annual Report, gross utility plant-in-service at the end of the test year amounted to \$1,349,887. Contributions in aid of construction totaled \$617,609 at the end of the test period. Thus, depreciation on contributed property comes to \$16,113, or 45.75 percent of total depreciation expense.

East Laurel proposed to adjust depreciation expense to reflect depreciation on the portion of the proposed new construction to be financed by loan funds, at a rate of 2 percent. The Commission concurs with this approach inasmuch as it excludes depreciation on contributed property and has therefore allowed, for rate-making purposes, depreciation expense on new construction of \$7,100.

After consideration of the above adjustments the Commission has allowed, for rate-making purposes herein, total depreciation expense of \$26,204.

Rate Case Expense

The District's rate case expenses were \$5,567. The Commission is of the opinion that such expenses, for rate-making purposes, should be amortized over 3 years. Thus, rate case expense of \$1,856 has been included.

Interest on Long-Term Debt

In its application, East Laurel proposed an adjustment of \$27,978 to Account No. 427--Interest on Long-Term Debt, based on \$361,000 at an interest rate of 7.75 percent. At the hearing of July 16, 1986, East Laurel corrected its calculation to the interest on \$355,000, the exact amount of the bonds to be purchased by Farmers Home Administration. For rate-making purposes, the Commission has included an adjustment of \$27,327, the average of the first 5 years of East Laurel's interest requirement for the 1986 bonds.

After consideration of the aforementioned adjustments, the Commission finds East Laurel's test period operations to be as follows:

	Test Period Reported	Pro Forma Adjustments	Test Period Adjusted
Operating Revenues	\$225,684	\$ -0-	\$225,684
Operating Expenses	202,835	4,198	207,033
Net Operating Income	\$ 22,849	\$ <4,198>	\$ 18,651
Other Income	7,359	-0-	7,359
Other Expense	30,864	27,327	58,191
NET INCOME	<u>\$ &lt;656&gt;</u>	<u>\$&lt;31,525&gt;</u>	<u>\$&lt;32,181&gt;</u>

#### REVENUE REQUIREMENTS

The Commission is of the opinion that the adjusted test-period operating loss is unfair, unjust and unreasonable. The Commission finds the Debt Service Coverage ("DSC") method to be a fair, just and reasonable method of determining revenue requirements in this case and adequate to allow East Laurel to pay its operating expenses, meet its debt service requirements and maintain a reasonable surplus. The Commission finds East Laurel's revenue requirement to be \$290,089 based upon a 1.2X DSC which would require an increase in annual revenue of \$57,046 from sales of water.

#### OTHER ISSUES

At the hearing East Laurel stated that the service connection fees collected from applicants to be served by its proposed construction had not been deposited into an interest-bearing account until approximately a week before the hearing. Instead, these fees had been kept in a safe at East Laurel's office for almost a year. Since these funds will be disbursed for the current construction project and not available on an ongoing basis, no adjustment has been made to Account No. 419 - Interest and Dividend Income. However, the Commission is concerned with East Laurel's management of service connection fees in this instance. If East Laurel should embark upon another construction project, it should deposit its service connection fees into an interest-bearing account as soon as such fees are received.

### FINDINGS AND ORDERS

The Commission, after consideration of the application and evidence of record and being advised, is of the opinion and finds that:

1. The rates proposed by East Laurel would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

2. The rates in Appendix A are fair, just and reasonable rates for East Laurel in that they will produce gross annual revenues from water sales of \$278,077. These revenues along with other operating revenues of \$4,653 and other income of \$7,359 will be sufficient to meet East Laurel's operating expenses found reasonable for rate-making purposes, service its debt, and provide reasonable surplus.

3. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

4. The proposed project includes the construction of about 25.4 miles of distribution system pipeline (0.13 miles of 8-inch, 3.85 miles of 6-inch, 21.03 miles of 4-inch and .43 miles of 3-inch); 211 new service connections; two new booster-pumping stations, a 300,000-gallon water storage tank with an altitude valve, an access road to the tank site, a 4-inch master meter, and other appurtenances.

5. The low bids totaled \$606,632 (\$487,402 for distribution system construction and \$119,230 for the storage tank and access road). The funding required for this work will be approximately



\$768,750 including engineering design fees, legal fees, resident inspection, interest during construction and a construction contingency of about four percent. The \$768,750 funded for East Laurel's construction should, therefore, be adequate for completion of the proposed construction.

6. Any deviations from the construction herein approved which could adversely affect service to any customer should be done only with the prior approval of this Commission.

7. East Laurel should furnish duly verified documentation of the total costs of this construction including all capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Said costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

8. East Laurel's contract with its Engineer should require full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering to insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

9. East Laurel should require the Engineer to furnish a copy of the "as-built" drawings and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

10. A 5/8-inch x 3/4-inch meter should be the standard customer service meter for all new customers and should be installed at all points of service unless the customer provides sufficient justification for the installation of a larger meter.

11. The \$768,750 financing plan proposed by East Laurel is for lawful objects within its corporate purposes, is necessary and appropriate for and consistent with the proper performance of its services to the public and will not impair its ability to perform these services, is reasonably necessary and appropriate for such purposes and should, therefore, be approved.

IT IS THEREFORE ORDERED that:

1. The rates proposed by East Laurel be and they hereby are denied.

2. The rates in Appendix A be and they hereby are approved for service rendered by East Laurel on and after the date of this Order.

3. East Laurel be and it hereby is granted a certificate of public convenience and necessity to proceed with the proposed construction as set forth in the plans and specifications of record herein.

4. East Laurel's plan of financing consisting of applicant contributions in the amount of \$52,750, a loan from the FmHA in the amount of \$355,000 with an interest rate of 7 3/4 percent and a 40-year term, and a grant from the FmHA in the amount of \$361,000 be and it hereby is approved.

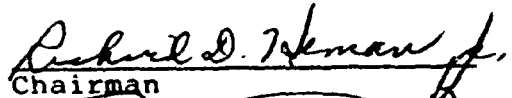
5. East Laurel shall comply with all matters set out in Findings 6 through 10 as if the same were individually so ordered.

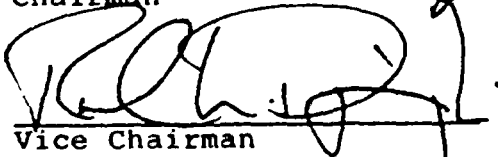
6. Within 30 days from the date of this Order East Laurel shall file with this Commission its revised tariff sheets setting out the rates approved herein.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 8th day of August, 1986.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

\_\_\_\_\_  
Executive Director

## APPENDIX A

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9525 DATED AUGUST 8, 1986

The following rates and charges are prescribed for the customers in the area served by East Laurel Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

#### Rates: Monthly

First 2,000 gallons	\$8.20 Minimum Bill
Next 2,000 gallons	2.98 per 1,000 gallons
Next 2,000 gallons	2.45 per 1,000 gallons
Next 4,000 gallons	1.87 per 1,000 gallons
Over 10,000 gallons	1.60 per 1,000 gallons